QUARTERLY REPORT ON THE SPANISH ECONOMY

OVERVIEW

During 2013 the Spanish economy moved on a gradually improving path that enabled it to exit the contractionary phase dating back to early 2011. This came about against a background of easing tensions on financial markets, the progressive normalisation of external funding flows, and improved confidence and a better performance by the labour market. Following a small rise in GDP in 2013 Q3 (of 0.1% in quarter-on-quarter terms), the economy is estimated to have grown at a quarterly rate of 0.3% in Q4, making for a zero rate of change compared with 2012 Q4. On the spending side, national demand is expected to have posted a similar quarterly increase to that in Q3 (0.3%) and net external demand is estimated to have risen slightly, with a zero contribution to output.

In light of the final stretch of the year, and despite its improving profile, GDP is expected to have declined by 1.2% in 2013 as a whole, a rate which largely reflects the carryover effect stemming from the marked fall-off in activity at the end of 2012. The decline in production in 2013 on average was the outcome of the fall in national demand (-2.8%), despite the fact the rate of contraction of this variable progressively diminished during the year, to the point of posting small quarter-on-quarter increases as from the summer for the first time since late 2010. All its components showed an improvement as the year unfolded, more intensely so in the case of private consumption, for which positive rates of change were recorded in Q3. The negative contribution of the public components of spending to activity diminished following the European Council's decision in June to relax the budgetary target for 2013 from 4.5% to 6.5% of GDP under the new path set.[1] For the sixth year running, net external demand softened the impact of the contraction in domestic spending on activity, with an estimated contribution of 1.6 pp to output. Underpinning this was the expansion of exports, since imports stabilised after having fallen markedly the previous year. The export performance was reflected in a far higher growth of sales to the rest of the world than in that of export markets, and in an exceptionally favourable performance by tourism exports. The contribution of net external demand nonetheless evidenced a declining trajectory as exports progressively slowed, following the weakening of the emerging economies, and purchases from the rest of the world rose owing to the incipient recovery in final demand.

From the supply-side standpoint, the declines in the value added of the various productive sectors in annual average terms were smaller than those of the previous year, and the better performance over the course of 2013 was manifest in the small rises in industry and in market services as from Q3. Employment also fell at a lower rate than in 2012, with an estimated 3.3% decline in numbers employed. That said, and as in the case of GDP, this annual figure reflects a notable carryover effect prompted by the adverse behaviour of employment in the final stretch of 2012. Indeed, the pace of job destruction slackened as the year unfolded, with limited job creation in net terms being estimated for the final quarter for the first time since early 2008. The unemployment rate continued on a declining course as from Q1, when it stood at 27.2% of the labour force, to 26% in Q3, set against the improvement in job flows and the steeper decline in the labour force. Labour costs continued in 2013 on the moderating path that had marked their course in 2012. For the

1 This decision was taken in June 2013 in a broader setting in which, following the end of the European Semester, it was agreed to extend the term within which the budget deficit was to be placed below 3% for those economies facing a greater macroeconomic downturn (in the case of the Spanish economy the extension was for two years, to 2016).

MAIN SPANISH MACROECONOMIC AGGREGATES (a) — TABLE 1

	2012	2013	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4
National Accounts										
Quarter-on-quarter rate of change, unless otherwise indicated										
GDP	-1.6	-1.2	-0.4	-0.5	-0.4	-0.8	-0.4	-0.1	0.1	0.3
Private consumption	-2.8	-2.4	0.2	-1.1	-0.7	-2.0	-0.6	0.0	0.4	0.4
Gross capital formation	-6.9	-5.6	-1.4	-3.2	0.2	-3.0	-1.4	-2.1	0.1	1.1
Domestic demand	-4.1	-2.8	-0.5	-1.3	-1.0	-1.8	-0.4	-0.6	0.3	0.3
Exports	2.1	5.0	-3.1	0.6	6.5	0.6	-4.3	6.4	2.2	-0.6
Imports	-5.7	0.3	-3.3	-2.2	4.6	-2.6	-4.5	5.2	2.8	-0.6
Contribution of net external demand (b)	2.5	1.6	0.1	0.8	0.6	1.1	0.0	0.5	-0.1	0.0
Year-on-year rate of change										
GDP	-1.6	-1.2	-1.2	-1.6	-1.7	-2.1	-2.0	-1.6	-1.1	0.0
Employment	-4.8	-3.3	-4.3	-5.1	-4.7	-5.0	-4.6	-3.9	-3.2	-1.5
GDP deflator	0.0	0.9	-0.1	-0.1	0.2	0.0	1.2	0.7	0.4	1.1
Price indicators (year-on-year rate of end-period data)										
CPI	2.4	1.4	1.9	1.9	3.4	2.9	2.4	2.1	0.3	0.3
CPI excl. unprocessed food and energy	1.6	1.4	1.2	1.3	2.1	2.1	2.3	2.0	0.8	0.2
HICP	2.4	1.5	1.8	1.8	3.5	3.0	2.6	2.2	0.5	0.3
HICP difference vis-à-vis the euro area	-0.1	0.2	-0.9	-0.6	0.9	0.8	0.9	0.6	-0.6	-0.5

SOURCES: INE and Banco de España.

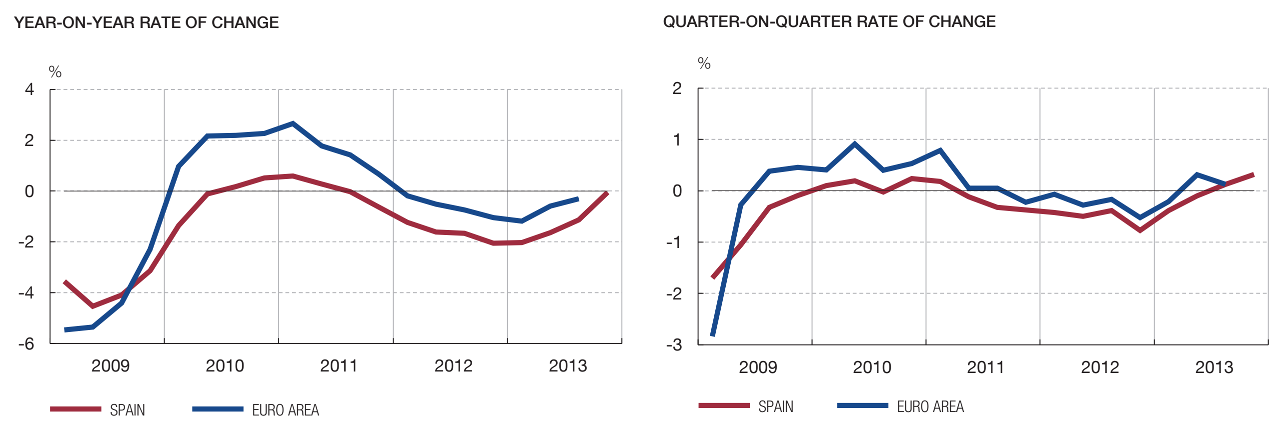
a Information available up to 17 January 2014.
b Contribution to the quarter-on-quarter rate of change in GDP in pp.

year on average, compensation per employee in the market economy is expected to stabilise at the previous year's levels, and to rise marginally in terms of the whole economy (0.7%), a development stemming from the base effect of the decline in public-sector wages in December 2012. Overall, unit labour costs underwent a fresh decline of 1.4% (albeit for a lesser amount on average than the previous year owing to the slowdown in productivity gains), which is expected to have provided for the continuation of the ongoing recovery in competitiveness. In 2013 the economy is estimated to have posted net lending capacity for the first time since 1997, the result above all of the improvement in the non-energy goods trade balance. On Balance of Payments data to October, the nation's net lending stood at 1.4% of GDP (in 12-month cumulated terms).

In turn, the inflation rate slowed markedly in the second half of the year, as the base effects of the rise in certain administered prices and the September 2012 hike in VAT were stripped out. Besides these statistical effects, price stability prevailed throughout the year. At the end of 2013 the CPI posted a year-on-year rate of 0.3% in December (0.2% in terms of the CPI excluding unprocessed food and energy), leading to a negative inflation differential with the euro area of 0.5 pp. This result suggests a limited pass-through of the indirect tax rises to final prices, as was foreseeable given the cyclical weakness and the significant progress in the ongoing deindexation of the economy.

On the international economic stage, economic activity firmed in the closing months of 2013 in the developed economies while the slowdown in the emerging economies slackened following the poor figures the previous quarter, set against the easing of the uncertainty that had prevailed since the spring. Contributing to this were favourable financial conditions and inflation rates that held at low levels, foreshadowing the continued

GROSS DOMESTIC PRODUCT (a) CHART 1



SOURCES: ECB, INE and Banco de España.

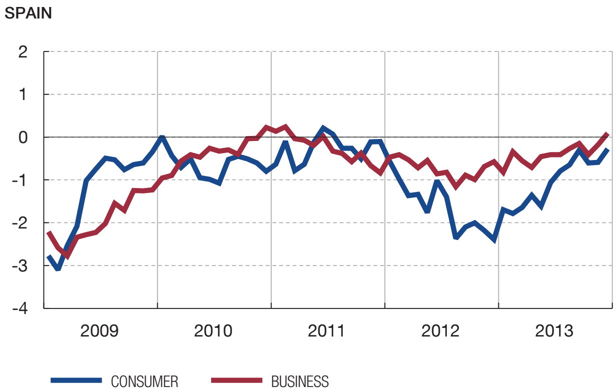
a Seasonally adjusted series.

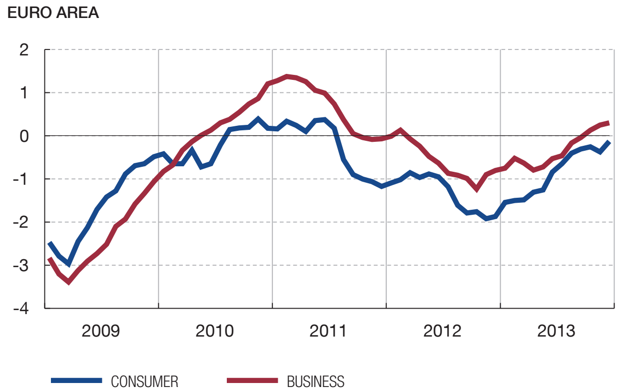
application of expansionary monetary policies by the main central banks for a prolonged period of time. Commodities prices were stable, with oil moving on a moderately declining trend. On the foreign exchange markets, the dollar depreciated against the main currencies, with the exception of the yen.

In the euro area, the stabilisation of the financial situation continued. As a result, the stress indicators fell to the levels in place before the start of the sovereign debt crisis in late 2009. However, fragmentation continues to mark the area's financial markets, which translates into the persistence of excessively strict financing conditions for households and firms in those countries where the cyclical recovery is more lagged, thereby countering the expansionary stance of monetary policy. It should be stressed that in recent months there has been significant progress in developing the legislative framework of the Banking Union, which is the main course of action being pursued to counter the fragmentation of the euro area financial markets.

The latest economic indicators point to a somewhat higher pace of activity in the euro area than in Q3, building on the scenario of muted economic recovery initiated in the summer months. Against this background, inflation continued to ease, ending the year at an annual rate of 0.8% in terms of the HICP, practically on a par with core inflation (0.7%), which excludes the more volatile components. Forecasts for the relevant monetary policy horizon foresee inflation standing significantly below 2% in a setting in which the economy will remain sluggish. In these circumstances, the ECB Governing Council stepped up its expansionary monetary policy stance in November with a 25 bp cut in interest rates on its main refinancing operations and on the marginal lending facility, which were set at 0.25% and 0.75%, respectively, and it held the rate on the deposit facility unchanged at 0%. It further reiterated its intention to hold official interest rates at their current levels, or lower if necessary, for a prolonged period of time. At the press conference following the January Governing Council, President Draghi made clear the scenarios under which, should current conditions continue, monetary policy would be made more accommodating (a possible worsening in medium-term inflation projections or an unwarranted rise in short-term money market interest rates). In respect of liquidity-providing measures, the Council had decided in November last year to continue conducting the ECB's main refinancing operations as fixed-rate tender procedures with full allotment for as long as necessary, and at least until mid-2015.

CONFIDENCE INDICATORS (a) CHART 2





SOURCE: European Commission.

a Normalised confidence indicators (difference between the indicator and its mean value, divided by the standard deviation).

In Spain, the Financial Assistance Programme for the recapitalisation of certain credit institutions was successfully concluded on schedule in 2013 Q4, and the Spanish sovereign debt rating outlook was upgraded (from negative to stable) by two credit rating agencies. As regards non-financial economic policies, substantial fiscal policy measures were approved. These included most notably the entry into force of the legislation creating the Independent Fiscal Responsibility Authority, which completes the ongoing improvement of the budgetary framework seen in recent years[2], and the Organic Law regulating the Social Security Pensions System Sustainability Factor and Revaluation Index, both of which are necessary to secure the medium-term sustainability of the pensions system.[3] In the labour market, changes were introduced that chiefly affected the regulation of part-time contracts, aimed at promoting their more flexible use.[4]

Spanish financial markets were party to the improvement recorded in the euro area. Marked declines in yields on public debt and their spread over the German benchmark were recorded, standing at levels slightly below 200 bp as at the cut-off date for this Bulletin, and the risk premia on private credit also fell. Stock market prices also rose sharply, taking IBEX-35 gains to 21% for the year as a whole, a trajectory that has continued in 2014 to date.

The pass-through of this improvement to non-financial private-sector financing conditions was, however, limited. Testifying to this were the interest rates on lending extended to households and firms, which fell by a small amount and only for specific types of loans (consumer loans in the case of households, and loans of limited amounts in the case of corporations), meaning they remain at very high levels given the monetary policy stance. Notwithstanding, the more favourable external environment, diminished uncertainty and

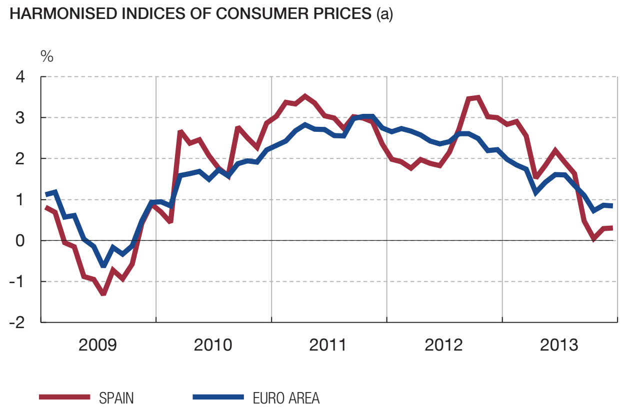
2 Organic Law 6/2013 of 14 November 2013 creating the Independent Fiscal Responsibility Authority, whose mandate includes assessment of the macroeconomic projections of budgetary plans and analysis of fiscal policy implementation and application.

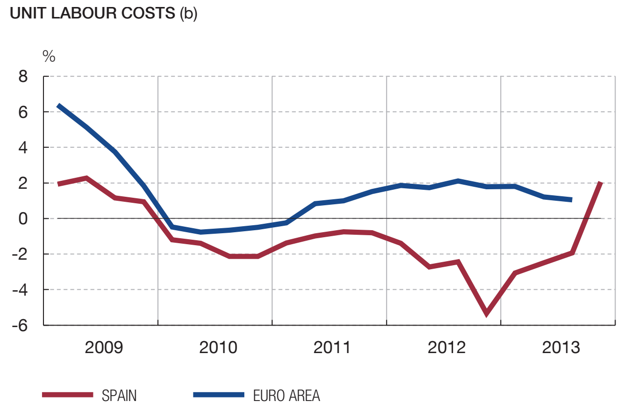
3 Law 23/2013 of 23 December 2013 regulating the Sustainability Factor and the Revaluation Index of the Social Security Pensions System. On 20 December, Organic Law 9/2013 on the control of trade debt in the public sector was also approved. This legislation establishes indicators and procedures conducive to bringing payments by the various public entities into line with legal limits. In the closing months of the year, moreover, the first tranche of the third phase of the Supplier Payment Plan was implemented. According to information from the Ministry of Finance and General Government, that would have entailed the payment of outstanding invoices of the order of €5.4 billion to suppliers of general government.

4 Royal Decree-Law 16/2013 of 20 December 2013 on measures conducive to stable hiring and to improving the employability of workers.

PRICES AND COSTS

CHART 3





SOURCES: Eurostat, ECB and INE.

a Year-on-year rate of change.
b Per unit of output. Year-on-year rate of change calculated on the basis of seasonally adjusted series.

some change in the labour market outlook helped underpin somewhat more favourable household and corporate spending figures.

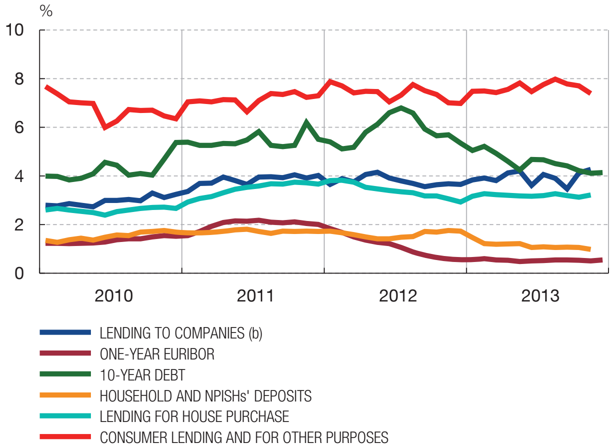
Household consumption showed signs of recovering in the second half of 2013. This followed two years of declines, which had been particularly acute in the final stretch of 2012 owing to the impact of a set of fiscal consolidation measures whose effect centred on household income during those months. An increase in consumption of a similar amount to Q3 is expected in 2013 Q4 and, if confirmed, it would mean a 2.4% decline in the attendant annual average rate. The mild pick-up in consumption during the year came about against the background of a slowing decline in disposable income, which was more pronounced in real terms owing to the lesser increase in prices in 2013, and of the more favourable performance of the financial component of household wealth. The saving rate held around its end-2012 levels (10.5% of disposable income in 2013 Q3, in four-quarter cumulated terms), in contrast to the markedly declining trajectory of this variable from its 2009 peak (of 17.8%), which may be indicative of the progressive tapering off of the resort to saving as a means of smoothing consumption, used intensively in the preceding years.

Residential investment continued to fall in the closing months of the year, albeit at a slightly lower rate than in the summer months, with an estimated annual average decline of 8%. On the back of this result, investment in housing is expected to have fallen for the sixth year running and its weight in GDP to have declined by somewhat more than 65% from its end-2006 peak, to stand at 4.2% of GDP. Housing transactions followed a contractionary pattern, as a result of the weakness of the underlying determinants (chiefly disposable income and financing conditions) and the impact of less favourable tax arrangements, following the raising of VAT and the elimination of the tax deduction for acquisition of the main residence in January 2013. However, new housing transactions increased by 4% in the first nine months of 2013, the result of the buoyancy of purchases by foreigners. Construction permits fell once again in 2013 to historical lows, which may indicate that the adjustment of the real estate sector will continue this year, although its impact on GDP will be increasingly smaller. Finally, on more lagged information, the declining course of house prices is expected to have eased during 2013. According to Spanish Ministry of Development figures, house prices are estimated to have fallen in Q3 at a year-on-year rate of 4.5%, entailing an adjustment from their 2008 Q1 peak of 28.8% (35.7% in real terms).

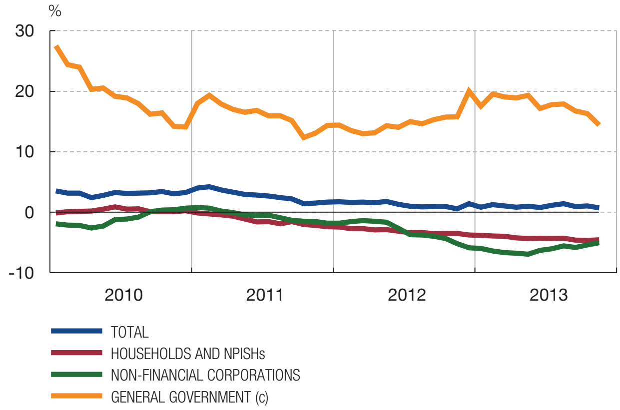
FINANCIAL INDICATORS OF THE SPANISH ECONOMY

CHART 4

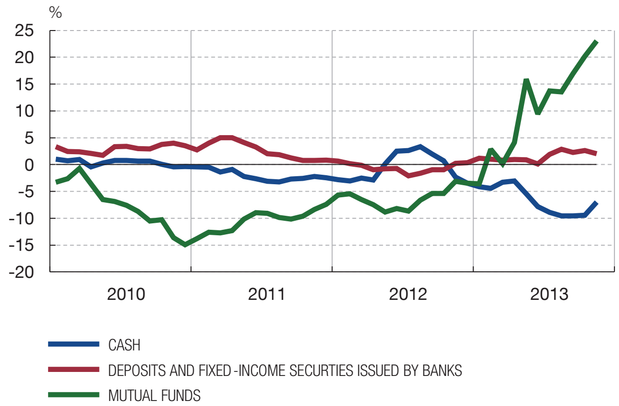
INTEREST RATES (a)



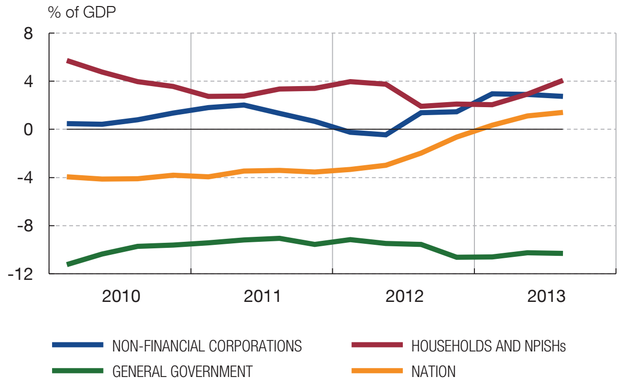
FINANCING TO NON-FINANCIAL RESIDENT SECTORS
Year-on-year growth



FINANCIAL ASSETS OF NON-FINANCIAL CORPORATIONS AND OF HOUSEHOLDS AND NPISHs
Year-on-year growth



NET FINANCIAL TRANSACTIONS (d)



SOURCE: Banco de España.

a In June 2010 the statistical requirements relating to interest rates applied by credit institutions to their customers were amended, potentially causing breaks in the attendant series. Of particular signifcance was the change in the interest rates on consumer credit and other loans, as a result of which, from that month, operations transacted using credit cards have not been included. APR for loans (includes commissions and other expenses) and NDER for deposits.
b Weighted average of interest rates on various transactions grouped according to their volume. For loans exceeding €1 million, the interest rate is obtained by adding to the NDER (Narrowly Defined Effective Rate), which does not include commission and other expenses, a moving average of such expenses.
c Consolidated financing: net of securities and loans that are general government assets.
d Four-quarter cumulated data. GDP is seasonally adjusted.

Drawing on information from the institutional sectors accounts, the difference between household saving and investment scarcely altered in 2013, resulting in net lending of 2.6% of GDP in Q3 (in four-quarter cumulated terms), similar to that in 2012. Household financing shows, on information to November, a similar year-on-year rate of decline to that at the end of Q3, at 4.6%.

Business investment picked up moderately in the final stretch of the year, although the behaviour of its two main components continued to differ. On one hand, a moderate rise in investment in equipment is estimated, further to stronger confidence, the continuing degree of dynamism in export orders (slacker in the closing months of the year) and the incipient improvement in the outlook for domestic demand. On the other, investment in other construction, largely linked to the execution of civil engineering projects, might be expected to have fallen once more, albeit at a lesser pace than in the previous quarters.

In 2013 the financial position of non-financial corporations improved substantially, as evidenced by the upward course of the sector's net lending capacity, which rose to 4.2% of GDP in 2013 Q3 (in four-quarter cumulated terms), compared with 1.1% of GDP the previous year. The generation of internal funds that this process (the surplus of saving over investment) involves helps reduce the company's dependence on external funding sources, whereby it might be a relatively extended practice given the context of strict financing conditions that has prevailed in recent years. In the most recent period, the rate of contraction of debt in the corporations sector slackened, to a year-on-year rate of 5.2% in November, compared with 5.9% two months earlier. The progressive reduction in the pace of decline of lending to corporations observed since June with the aggregate data is also discernible in the SMEs segment. By sector of activity, this change is more marked in construction and real estate services than in the other sectors.

Turning to trade with the rest of the world, the latest information available for the closing months of 2013 suggests that net external demand has made a zero contribution to quarter-on-quarter GDP growth at the close of the year. This outcome has come about owing to the moderation both in exports, since the improvement in euro area markets would not have offset the slowdown in the emerging economies as a whole, and in imports, whose pace of growth is expected to have slackened compared with their greater buoyancy mid-year.

As regards fiscal consolidation, the overall general government sector posted a deficit of 4.4% of GDP (excluding assistance to financial institutions) in the January-September 2013 period, slightly worse than the figure of 4.3% for the same period a year earlier. In four-quarter cumulated terms, the general government deficit stood at 7% of GDP. Fulfilment of the deficit target of 6.5% of GDP for 2013 should therefore have entailed a considerable improvement in public finances in Q4, greater than that observed in the same quarter of 2012. As to general government debt, the cumulative volume at the end of Q3 amounted to 93.4% of GDP, marking a fresh quarterly increase, albeit at a more moderate pace than in the recent past.

In terms of the application of European budgetary rules, the European Commission published on 15 November its opinion on the documents submitted to it in October by the Government. On the basis of its latest forecasts, the Commission considered that the Spanish Government had taken effective measures in 2013 in line with fulfilment of the recommendations made by the European Council of 21 June. With regard to 2014, however, the Commission signalled downside risks to the economic growth projections and the structural fiscal drive included in the Government's plans.

The sectoral indicators available point to a firming during Q4 of the gradual pick-up in activity, underpinned chiefly by the services sector and, to a lesser extent, manufacturing industry. As indicated, a clear improvement was observed in employment, the figures for which are estimated to be marginally positive in net terms, after having stabilised in Q3. That would place the year-on-year rate of decline in employment at around 1.5% (-3.2% in the previous quarter). These developments mark an intensification of the moderating course of growth of apparent labour productivity observed since early 2013, which is expected to stand at around 1.5%, compared with 3.1% at end-2012. The more favourable performance of employment was across all sectors of activity, according to the information available on Social Security registrations, with quarter-on-quarter declines being observed in employment in industry and in construction, albeit at more moderate rates than in the previous quarter, and a rise in employment in the market services sectors. In non-market services there was a year-on-year increase in registrations, following the declines in the preceding quarters. Registered unemployment posted a year-on-year fall for the first time since 2007 Q2, thanks to the better performance of employment and to the continuing declining path of the labour force.

The labour costs indicators available for 2013 Q4 substantiate the pattern of wage restraint observable since the beginning of the year. The average increase in wage rates to December was 0.6% (1% to 2012), with smaller increases among newly signed collective agreements (0.4%). Continuing wage moderation, which is expected to be already yielding results in terms of job creation, is key to helping ensure that the recovery in activity under way should translate into an appreciable reduction in the high rate of unemployment.

20.1.2014.